
Tobacco Master Settlement Agreement and Non Participating Manufacturer Enforcement

What is the Master Settlement Agreement?

The Master Settlement Agreement is an agreement between 46 states, including Michigan, several territories, and the District of Columbia (the settling states), and participating tobacco product manufacturers.

Michigan signed the Master Settlement Agreement (MSA) on November 23, 1998.

Tobacco product manufacturers who signed the MSA agreed to deposit funds annually into an escrow account for subsequent annual distribution to the settling states. The purpose of the funds is to substitute and replace existing and potential lawsuits filed against the tobacco product manufacturers.

What are the State's Responsibilities Under the Agreement?

Settling states must enact legislation that requires tobacco products manufacturers to either sign the MSA or, as non-participating manufacturers (NPM's), establish qualified escrow accounts and deposit funds annually, based on the number of cigarettes they sold in each calendar year in the state.

The states are also responsible for diligently enforcing the legislation they enact, and failure to do so could result in a substantial reduction of the funds allocated to the state from funds deposited by the participating manufacturers.

Participating manufacturers must adhere to certain marketing restrictions that do not apply to manufacturers who are not participating in the MSA. The lack of restrictions placed on NPM's could have an adverse affect on the market share of the participating manufacturers. The MSA provides protection from losses in the market share of the participating manufacturers by allowing reductions in a states share of the participating manufacturers' payments if it is shown that the state has not diligently enforced its enacted legislation, and the failure to enforce has resulted in a loss of market share of a specified percentage for the participating manufacturers.

Act 244 of 1999 (MCL 445.2051 – MCL 445.2052)

The Michigan Legislature enacted PA 244 on December 28, 1999. Act 244 requires that tobacco product manufacturers either participate in the MSA or, as non-participating manufacturers, deposit funds by April 15th of each year into qualified escrow accounts based on the number of cigarettes sold within Michigan, either directly or through intermediaries, in each calendar year.

For purposes of Act 244 the definition of 'cigarette' includes 'roll-your-own' (RYO) tobacco. (.09 ounces of RYO tobacco equals 1 cigarette)

The NPM must file with the department an annual Notification of Compliance, reporting the total units sold during the calendar year, the amount deposited in escrow, and the name and address of the financial institution that holds the escrow account. A copy of

the escrow agreement with the financial institution and proof of deposit must accompany the Notification.

Penalties For Non-Compliance by NPM's

The Attorney General may bring a civil action against any NPM who fails to deposit funds into a qualified escrow account for sales made within Michigan during each calendar year.

Upon notification the NPM is required to deposit funds in escrow within 15 days. If the court finds that a violation has occurred it may impose a civil penalty of up to 5% of the amount improperly withheld from escrow per day. The total penalty may not exceed 100% of the amount improperly withheld.

If a violation has occurred in the next year ("knowing violation"), and the NPM again fails to place funds in escrow within 15 days, the court may impose a civil penalty of up to 15% of the amount improperly withheld per day. The total penalty may not exceed 300% of the amount improperly withheld.

If a violation has occurred in the second succeeding year ("second knowing violation"), the NPM is prohibited from selling cigarettes to consumers within Michigan for a period of up to 2 years.

Each failure to deposit the required funds constitutes a separate violation.

Key Definitions From Act 244 of 1999

Sec. 1(l): "Tobacco product manufacturer" means an entity that after the date of enactment of this act directly (and not exclusively through any affiliate) meets 1 or more of the following:

- (i) Manufactures cigarettes anywhere that such manufacturer intends to be sold in the United States, including cigarettes intended to be sold in the United States through an importer (except where such importer is an original participating manufacturer that will be responsible for the payments under the master settlement agreement with respect to such cigarettes as a result of the provisions of subsection 11(z) of the master settlement agreement, and provided that the manufacturer of such cigarettes does not market or advertise such cigarettes in the United States.
- (ii) Is the first purchaser anywhere for resale in the United States of cigarettes manufactured anywhere that the manufacturer does not intend to be sold in the United States.
- (iii) Becomes a successor of an entity described in subparagraph (i) or (ii).

Sec. 1(m): The term "tobacco product manufacturer" as defined in subdivision (l) does not include an affiliate of a tobacco product manufacturer unless the affiliate itself falls within 1 or more of subdivision (l)(i) to (iii).

Sec. 1(d): "Cigarette" means any product that contains nicotine, is intended to be burned or heated under ordinary conditions of use, and consists of or contains (i) any roll of tobacco wrapped in paper or in any substance not containing tobacco; or (ii) tobacco, in any form, that is functional in the product, which, because of its appearance, the type of tobacco used in the filler, or its packaging and labeling, is likely to be offered to, or

purchased by, consumers as a cigarette; or (iii) any roll of tobacco wrapped in any substance containing tobacco which, because of its appearance, the type of tobacco used in the filler, or its packaging or labeling, is likely to be offered to, or purchased by, consumers as a cigarette described in clause (i) of the definition. The term "cigarette" includes "roll-your-own" (i.e., any tobacco which, because of its appearance, type, packaging, or labeling is suitable for use and likely to be offered to, or purchased by, consumers as tobacco for making cigarettes). For purposes of this definition of "cigarette", 0.09 ounces of "roll-your-own" tobacco shall constitute 1 individual "cigarette".

Sec. 1(n): "Units sold" means the number of individual cigarettes sold in the state by the applicable tobacco product manufacturer (whether directly or through a distributor, retailer, or similar intermediary or intermediaries) during the year in question, as measured by excise taxes collected by the state on packs (or "roll-your-own" tobacco containers) bearing the excise tax stamp of the state. The department of treasury shall promulgate such regulations as are necessary to ascertain the amount of state excise tax paid on the cigarettes of such tobacco product manufacturer for each year.

Calculation of the Amount to be Deposited in a Qualified Escrow Account

Sec. 2(b)(i) to (v) specifies the rate to be used each year to calculate the amount to be deposited in a qualified escrow account. The rates specified are to be adjusted for inflation.

For Sales in 1999

\$.0094241 adjusted for inflation to \$.0097068

For Sales in 2000

\$.0104712 adjusted for inflation to \$.0111506

For Sales in 2001

\$.0136125 adjusted for inflation to \$.0149306

To arrive at the amount to be escrowed multiply the total units sold by the adjusted rate.

Example:

If, in 2000, the NPM sold 10,000 cigarettes and 3 pounds of 'roll-your-own' tobacco, the total units sold would be 10,533. (3 pounds multiplied by 16 ounces, divided by 0.09 = 533 cigarettes.)

10,533 units sold multiplied by \$.0111506 (adjusted rate for 2000) = \$117.45

Amendments to Act 327 of 1993 (MCL 205.421 - MCL205.436) by Act --- of 2002

The Michigan Legislature has enacted amendments to PA 1993, No. 327, the Tobacco Products Tax Act, which support enforcement of PA 1999, No. 244.

A non-participating manufacturer (NPM) is required to certify to the department annually that it is not participating in the Master Settlement Agreement (MSA), and that it has established a qualified escrow account and deposited funds as required under Act 244 of 1999. (Sec. 6C) Certification of Compliance forms are available from the department.

The NPM must provide copies of the Certification to the Attorney General and anyone to whom they sell their cigarettes for resale in Michigan. (Sec. 6C(s)) The person receiving the Certifications must retain them for at least 4 years. (Sec. 6C(4))

The Act requires that wholesalers and unclassified acquirers report all cigarettes, including 'roll-your-own' tobacco, acquired during each reporting month that were manufactured by an NPM. (Sec. 6C(5)) Schedule K has been developed to report these transactions. Returns to the NPM or exports to out-of-state customers are also reported on Schedule K.

Upon enactment of these amendments, if licensed wholesalers or unclassified acquirers have not already submitted Schedule K's for periods subsequent to December 27, 1999 they are required to file Schedule K's for the lapsed periods within 60 days. Schedule K's must be filed even if there are no transactions to report. (Sec. 6C(5))

Failure to file Schedule K, or filing inaccurate schedules may result in 1 or more of the following:

1. Assessment of a penalty of up to \$1,000.00 per violation.
2. Prohibition from obtaining cigarette stamps from the department.
3. License revocation.

An NPM who has not provided the Certification required under this section is prohibited from making sales of cigarettes, including 'roll-your-own' tobacco, in Michigan, either directly or through an intermediary. (Sec. 6C(6)) No one may purchase tobacco products in Michigan, or for resale in Michigan, from an NPM who has not provided the Certification required under Sec. 6C. (Sec. 6C(7))

The department will post a list of NPM's who have met this requirement on its website. (Sec. 6C(8)) If a wholesaler or unclassified acquirer receives a Certification from an NPM whose name is not published by the department a copy is to be provided to the department within 10 business days. (Sec. 6C(9))

The department will post on its website the names of NPM's who have committed a second or subsequent knowing violation of Act 244 of 1999, or against whom the department has a judgement. 30 days after a name is posted the department may seize from any person cigarettes acquired from or manufactured by that NPM. (Sec. 6C(10))

In addition, effective May 1, 2003 if an NPM has not provided the required Certification the department may seize or confiscate from any person cigarettes acquired from or manufactured by that NPM. (Sec. 6C(10))

The department may impose a civil fine of up to \$1,000.00 for violations of this section, in addition to fines or penalties imposed under Act 244 of 1999. (Sec. 6C(11))

<u>Reporting of NPM Brands by Licensed Wholesalers and Unclassified Acquirers (Including Manufacturers)</u>
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Act 327 of 1999, as amended by HB 5248, requires that licensed wholesalers and unclassified acquirers file monthly Schedule K's with their tobacco products tax returns for all periods subsequent to December 27, 1999. The Schedule K is used to report the number of cigarette sticks, and volume (pounds or kilograms) or 'roll-your-own' tobacco

acquired or imported, the name of the NPM, and the brands of products acquired or imported. Products that are returned to the NPM if, for example, they are unsalable, or exported to other states are also reported on Schedule K, and deducted from acquisitions and/or imports to arrive at the units subject to the escrow requirement for the NPM. This provides the department with the means to verify that the proper amount of funds has been deposited in escrow by each NPM. Please refer to the page entitled 'Act 327 of 1993 (MCL 205.421 – MCL205.436)" for provisions and penalties. *(This will need a link to 'forms'.)*

Contacts

Questions about the filing of Schedule K should be directed to the Customer Contact Division, Tobacco Tax Unit at (517) 636-4630.

Technical questions concerning the MSA and Act 244 should be directed to the Technical Services Division at (517) 373-9600.